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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1946

No. 861 16

PRIEBE & SONS, INC.,

Petitioner,

vs.

THE UNITED STATES

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS AND BRIEF IN SUPPORT THEREOF.

SAMUEL WILLISTON,
Counsel for Petitioner.

J. ARTHUR MILLER,
ALLEN H. GARDNER,
Of Counsel.

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called FSCC, entered into a contract on April 23, 1942, for the sale to FSCC of dried eggs (R. 18, 19).

The contract provided that the petitioner would make, and the FSCC would accept, delivery at some time within a 10-day period beginning May 18, 1942, but that the particular day was at FSCC's option (R. 19, 22, 24, 25).

The FSCC by various notices directed petitioner to make immediate shipment of specified quantities of dried eggs (R. 26, 27). These notices were promptly followed by delivery of the eggs (R. 26, 27, 29-30). FSCC accepted the product and has never questioned its quantity or quality, nor the time or place of delivery (R. 27).

Subsequently, the FSCC imposed damages of $14,482.90 on the petitioner (R. 27-30). The FSCC notified the petitioner that the damages had been imposed under a contract provision calling for liquidated damages at 10 cents a pound on such quantities of dried eggs as were not ready for delivery on May 18, 1942, and that inspection certificates indicated that 144,829 pounds were not ready on that day (R. 27-30).

Paragraph 7 of the contract provided that "failure to have specified quantities of dried egg products inspected and ready for delivery by the date specified [May 18, 1942] • • • will be cause for invoking the provisions of Paragraph 9" (R. 22). Paragraph 9 provided that, since "the failure of the vendor to deliver the quantity of the commodity • • • specified • • • in accordance with the terms • • • will • • • cause serious and substantial damages to the purchaser," and since it would be difficult to prove the amount of the damages, the vendor agreed to pay the FSCC liquidated damages (R. 22-23). The damages were to be computed at a specified number of cents "for

each pound of dried egg product undelivered in accordance with the terms" of the contract (R. 23). The damages were to be 10 cents a pound when the specified first day of the 10-day delivery period (May 18, 1942) was no more than 50 days after the contract date (April 23, 1942), and were to increase by a graduated scale up to 30 cents a pound if the specified first day was from 246 to 311 days after the contract date (R. 23).

The contract provided that the vendor should arrange with an agency of the United States for inspection of the product, and should tender a grading certificate with each delivery (R. 20-22). The barrels used in shipping were to be marked with certain information concerning the product, the vendor, and the manufacturer, including a legend furnished by the FSCC (R. 21, 22).

The product on which the damages were imposed had all been manufactured before May 18, 1942, but the grading certificates which showed that the product was acceptable bore dates between May 20 and 22, 1942 (R. 26-27). The fact that these certificates were dated subsequent to May 18, 1942, was the basis for the imposition of damages (R. 30). The first notice to ship any of the eggs on which damages were imposed was dated May 26, 1942 (R. 26). The other notices to ship were dated May 29 and June 4, 1942 (R. 26, 27).

The petitioner sued in the Court of Claims to recover the damages with interest (R. 1, 7), but that Court held that the imposition of damages was proper (R. 32).

Question Presented

Whether the provision of paragraph 7 of the contract under which damages were imposed was an invalid pro-

vision for a penalty or an enforceable provision for liquidated damages.

Reason for Granting the Writ

The decision below is in flat, open conflict with a principle repeatedly enunciated in decisions of this Court and other authorities. This is the principle—one of the fundamental and universally applied rules of the law of contracts—that an agreement fixing damages for a future breach at an amount which is not a reasonable forecast of just compensation for the injury anticipated from the breach will be held unenforceable as a penalty. *Kothe* v. *Taylor Trust*, 280 U. S. 224, 226; *Irving Trust Co.* v. *Perry*, 293 U. S. 307, 311; *Wise* v. *United States*, 249 U. S. 361, 365-367; *United States* v. *Bethlehem Steel Co.*, 205 U. S. 105, 121; *Sun Printing & Publishing Association* v. *Moore*, 183 U. S. 642, 672-674; Restatement, Contracts, § 339, p. 552; Williston, Contracts (Rev. ed.), §§ 776-784.

In this case, paragraph 9 (R. 22, 23) provided for liquidated damages upon failure to make timely delivery whether such failure arose because the certificates were not ready when delivery was called for or for any other reason. Paragraph 7 (R. 22), as construed [1] by the Court of Claims (R. 36, 37), covered no situation not provided for by paragraph 9 except the case of a vendor who did not have eggs certificated and otherwise ready on May 18, 1942, but who delivered certificated eggs promptly on request by the FSAC. Therefore, the additional imposition specified under this construction of paragraph 7, applying as it did only to a situation where there could not possibly be any injury to

[1] See footnote 2, p. 9, with reference to the construction by the Court of Claims.

the United States, was not a pre-estimate of compensation for injury.

WHEREFORE, it is respectfully submitted that this petition should be granted.

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January, 1947.

BRIEF IN SUPPORT OF PETITION

Opinion Below

The majority and minority opinions of the Court of Claims (R. 33-40) are reported in — C. Cls. ——, 65 Fed. Supp. 457.

Jurisdiction

The judgment of the Court of Claims was entered May 6, 1946 (R. 40), and its order denying the petitioner's motion for a new trial was entered October 7, 1946 (R. 40). Jurisdiction is conferred on this Court by section 3(b) of the Act of February 13, 1925, 43 Stat. 936, 939, as amended by the Act of May 22, 1939, 53 Stat. 752.

Statement

The essential facts are stated in the preceding petition, pp. 1-3.

Question Presented

The question presented is stated in the foregoing petition, pp. 3, 4.

Specification of Errors to Be Urged

The Court of Claims erred:

1. In holding that the provision in question was an enforceable provision for liquidated damages rather than an invalid penalty clause.

2. In failing to hold that the amount fixed as damages for mere omission to have the certificates ready May 18, 1942, was not a reasonable forecast of just compensation for such a technical breach, and that accordingly the provision was unenforceable.

3. In failing to hold that the amount fixed as damages for mere omission to have the certificates ready May 18, 1942, was intended to be held *in terrorem* over the petitioner, and to force performance through the excessiveness of the amount, rather than to be a good faith pre-estimate of anticipated damages, and in failing to hold, as a consequence, that the provision was a penalty clause.

4. In attaching conclusive weight to the use of the contract term "liquidated damages" in holding that the provision was enforceable.

5. In failing to hold that the provision fixing the same damages for trivial as for serious breaches rendered it invalid as a penalty.

6. In dismissing the petition.

7. In denying the motion for a new trial.

Summary of Argument

The petitioner contracted to sell dried eggs to a Government agency. The petitioner made timely delivery of eggs of the proper quantity and quality, together with the required certificates, and the Government never raised any question as to such delivery. However, the Government imposed damages under its interpretation of paragraph 7 of the contract because of the technical omission to have the certificates ready by May 18, 1942. The petitioner sued in the Court below to recover the damages paid, but the Court gave judgment for the respondent.

The contract, in paragraph 9, imposed heavy damages for failure to deliver the eggs in accordance with the contract. This provision covered every case of contract deviation which could possibly injure the Government. The Court below in the majority opinion interpreted the con-

tract as also imposing, in paragraph 7, the same heavy damages for omission to have the certificates ready on May 18 even though the petitioner was not legally permitted to make delivery until a later date when the Government demanded shipment at which later time the eggs and the certificates were ready and were delivered. Since paragraph 9 would cover a case of failure to have the certificates ready on May 18 followed by failure to make proper delivery, it seems clear that paragraph 7 (if construed correctly by the Court) was intended to cover only the case where there was no failure to deliver according to the contract and consequently no possibility of injury, and where there was merely a technical omission to have the certificates ready on May 18—several days before the Government was prepared to accept or even permit delivery.

The provision for damages for such a technical omission without possibility of injury could not have been inserted in the contract as a pre-estimate of just compensation for harm anticipated from such an omission. The provision could only have been made to be held *in terrorem* over the petitioner in order to force performance through fear of an arbitrary, excessive exaction having no relationship to probable or even possible injury from a breach. In holding that the damages were properly imposed, the decision below is in plain, flat, hopeless conflict with a fundamental principle of the law of contracts firmly and uniformly established in decisions of this Court and other authorities. This is the principle that to be enforceable, a contractual provision fixing damages for a future breach must reflect a reasonable forecast of the damage likely to result from that breach.

The only procedure for correcting the total disregard in the decision below of this hitherto universally recognized

principle of contract law and to avoid serious confusion from such an unprecedented departure from existing law is for this Court to exercise its power of supervision over a trial court from which there is no appeal as a matter of right.

ARGUMENT

I

It was from the outset impossible that the FSCC could suffer any damage whatever for the omission (to have the eggs certificated before the FSCC was ready for delivery) for which damages were imposed upon the petitioner.

The contract clearly provided in paragraph 9 that the petitioner should pay damages if it failed to make delivery in accordance with the provisions of the contract (R. 22-23). One of the contract provisions gave the FSCC the right to demand shipment by the petitioner on May 18 and on any day within nine days thereafter. Failure to deliver according to the contract—whether for failure to have the certificates ready when the FSCC should demand shipment or for any other reason—embraced every breach which could cause harm to the FSCC.

But the contract also had an entirely separable provision in paragraph 7. This paragraph provided that the petitioner should pay the same damages (the same as in the case of failure to deliver in accordance with the contract) if the petitioner should not have the certificates ready on May 18, but should have them ready by the time FSCC demanded shipment and should make immediate delivery upon such demand.[2]

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[2] This is the interpretation given to paragraph 7 in the majority opinion below (R. 36-37). The dissenting opinion said that paragraph 7 did not impose damages in the circumstances of this case (R. 39, 40). There

It was, of course, foreseeable from the outset with certainty that the FSCC could not suffer any damage whatever for mere omission to have the certificates ready on any days which might elapse between May 18 and the day when the FSCC desired shipment. Hence, when the contract was executed the parties knew that there was no possibility of injury from the kind of omission for which damages were imposed on the petitioner under paragraph 7.

II

The provision imposing damages for omission to have the eggs certificated before the FSCC was ready for delivery did not give the FSCC "assurance" except as it was held in terrorem over the petitioner.

It may be said, as stated in the majority opinion below (R. 37), that the provision imposing damages for omission to have the certificates available on a day prior to the time when the FSCC was willing to accept delivery was needed to give the FSCC "assurance" that the eggs would be ready on May 18, and that the imposition of damages was justifiable for that reason. A brief analysis of the facts will show, however, that this provision did not and could not give the FSCC such assurance except as it was held *in terrorem* over the petitioner.

The fact is (whatever might have been the legal effect of a provision for such assurance) that the contract did not provide that the petitioner should give notice on May 18 that the certificates were ready. The FSCC did not know (and the procedure did not contemplate that it would know)

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is an inconsistency in providing (paragraph 7) that failure to have certificates ready on May 18 will invoke provisions (paragraph 9) which impose damages only for failure to make delivery, but the petitioner for the purpose of this brief accepts the construction of paragraph 7 by the majority.

whether the certificates were ready on May 18 until the records were checked subsequent to acceptance by the FSCC of all shipments here involved (R. 27, 29). Instead of depending on factual knowledge as the basis for its assurance, the FSCC relied on the imposition of damages under the provisions of paragraphs 9 and 7.

The heavy damages imposed by paragraph 9 for failure to deliver in accordance with the contract furnished a strong inducement to the petitioner to have the eggs certificated and otherwise ready by May 18. The operation of this inducement tended to give the FSCC assurance—a type of assurance which the petitioner does not criticize—that the certificates would be ready on May 18, or whenever FSCC demanded shipment.

But the FSCC also relied for such assurance on the provision of paragraph 7 which, as interpreted by the majority of the Court below, imposed damages for mere omission to have the certificates ready at a time before the FSCC was prepared to demand shipment. This paragraph did not make May 18 the delivery date but provided that the "date specified in the offer [May 18] • • • shall be the first day of a 10-day period within which the FSCC will accept delivery, the particular day within the period being at the FSCC's option" (R. 22). The petitioner had neither right nor duty nor indeed possibility of delivering on May 18 or on any other day until and unless it received notice of when and where to ship the eggs. This is so obvious that it would be superfluous to cite the many decisions from *Williston, Sales* (2d ed.), § 457, showing that the petitioner's duty was conditional on receiving such notice.

This provision in paragraph 7 imposing damages for an omission (which, as was foreseeable from the outset, could not possibly cause injury) to have the eggs certificated at a time before the petitioner had any duty or even oppor-

tunity to make delivery was clearly inserted to force the petitioner to have the certificates ready through fear of a heavy exaction. It was to be held *in terrorem* over the petitioner.

III

The decision below is in direct, open conflict with the universal rule, Federal and state, that a provision will not be enforced if it imposes damages for a default that can not possibly cause injury.

The validity of paragraph 7 imposing damages for default without possibility of injury is rather clearly governed by Federal law. *United States* v. *Allegheny*, 322 U. S. 174, 183; *Clearfield Trust Co.* v. *United States*, 318 U. S. 363, 366, holding inapplicable the rule of *Erie Railroad Co.* v. *Tompkins*, 304 U. S. 64. But whether this case is to be decided under Federal law, under the law of the States (Iowa and Minnesota) where the contract was to be performed, or under the law of some other state, the enforceability of the damage provision is controlled by a fundamental and hitherto universal principle of the law of contracts. This is the rule that, in distinguishing a provision for liquidated damages from one for a penalty, a provision will not be upheld as one for liquidated damages unless it is a reasonable forecast of injury.

The Federal rule is set forth in a number of decisions of this Court. Differences of expression will be found in the opinions in these cases, but no case is in conflict with the latest statement of this Court that "agreements to pay fixed sums plainly without reasonable relation to any probable damage which may follow a breach will not be enforced." *Kothe* v. *Taylor Trust*, 280 U. S. 224, 226. This principle was subsequently approved without citation

or discussion in *Irving Trust Co.* v. *Perry*, 293 U. S. 307, 311.

Other principal decisions of this Court on the distinction between liquidated damages and a penalty are those in *Wise* v. *United States*, 249 U. S. 361, 365-367, *United States* v. *Bethlehem Steel Co.*, 205 U. S. 105, 121, and *Sun Printing & Publishing Association* v. *Moore*, 183 U. S. 642, 672-674. In each case the provision for damages was sustained because the parties at the time the agreement was reached had made a reasonable pre-estimate, or at least a not greatly disproportionate estimate, of injury which might result from a future breach.

The majority of the Court below clearly misconstrued the opinion in *United States* v. *Bethlehem Steel Co.*, 205 U. S. 105, especially in relation to the intention of the parties (R. 38). In the *Bethlehem Steel* case, the United States contracted for gun-carriages while preparing for imminent war. The contract imposed $35 damages for each day of delay in delivery of each gun-carriage. Delay in delivery ensued and the United States deducted the agreed damages. There was evidence that the delay caused practically no damage. This Court held that the damage clause was for liquidated damages and not for a penalty, and stated (205 U. S., at page 121), as a main reason, that the "amount is not so extraordinarily disproportionate to the damage which might result from the failure to deliver the carriages" as to establish a penalty. If the present petitioner had failed under paragraph 9 to make timely delivery, this case would have been like the *Bethlehem Steel* case. But, as pointed out in the minority opinion below (R. 39), the *Bethlehem Steel* decision allowing damages for delay in delivery (which at the time of the Bethlehem Steel contract seemed likely to cause substantial injury) is inapplicable to the present petitioner's default under para-

graph 7 which the parties from the outset knew could not possibly cause injury.

This Court, in discussing the intention of the parties in the *Bethlehem Steel* case, made it clear that the term, "liquidated damages" or "penalty," used by the parties is not of itself conclusive in deciding whether the provision is for liquidated damages or for a penalty (205 U. S., at page 120), and that the relationship of the agreed damages to the prospective probable injury is important (205 U. S., at page 121).

Whatever may be the precise effect of the intention of the parties on this question, it is clear under the authorities that no expression of intention can make a provision one for liquidated damages when it is perfectly certain that there can be no damage at all. It is only in doubtful cases that the expression of intention can have determining force.

The rule in the State courts is well illustrated by decisions in the two States (Iowa and Minnesota) where this contract was to be performed. In *Fort Dodge Co-operative Dairy Marketing Association* v. *Ainsworth*, 217 Iowa 712, 716, the Court said:

> "• • • In order that specified damages shall be deemed as liquidated, it must appear that the sum provided shall be 'fairly related to the actual damage ordinarily suffered in like circumstances.'"

To similar effect are Minnesota decisions in *J. I. Case Threshing Machine Co.* v. *Fronk*, 105 Minn. 39, 41, and *Goodell* v. *Accumulative Income Corp.*, 185 Minn. 213, 215-219.

The universality of the "reasonable forecast" rule is clearly shown in Restatement, Contracts, § 339, p. 552, and in Williston, Contracts (Rev. ed.), §§ 776-784, where many cases are cited.

This principle is set forth in Restatement, Contracts, § 339, p. 552, thus:

> "An agreement, made in advance of breach, fixing the damages therefor, is not enforceable • • • unless
>
> "(a) the amount so fixed is a reasonable forecast of just compensation for the harm that is caused by the breach • • •"

And in Williston, Contracts (Rev. ed.), § 776, pp. 2183, 2184, this rule, coupled with the *in terrorem* badge of a penalty, is stated as follows:

> "• • • A penalty is a sum named, which is disproportionate to the damage which could have been anticipated from breach of the contract, and which is agreed upon in order to enforce performance • • • by the compulsion of this very disproportion. It is held *in terrorem* over the promisor to deter him from breaking his promise. Liquidated damages, on the other hand, is a sum fixed as an estimate made by the parties at the time when the contract is entered into, of the extent of the injury which a breach of the contract will cause. • • •"

The decision below upholding a provision which imposed damages for a default without possible injury and which hung *in terrorem* over the petitioner is, therefore, in direct, open conflict with a fundamental principle of the law of contracts as laid down in the uniform decisions on the point by this Court and by the other courts which have considered the question.

Conclusion

In conclusion, the decision below is in such flat conflict with all of the other decisions in this country on a fundamental principle of contract law that an exercise of this Court's power of supervision is demanded to avoid the

serious confusion which the trial court's unprecedented departure from existing law is likely to cause. It is, therefore, respectfully submitted that the petition should be granted.

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